

VZCZCXYZ0007
OO RUEHWEB

DE RUEHUL #1031/01 0880822
ZNR UUUUU ZZH (CCY TEXT PARA 1 & 2 ADADE3BB MSI7542)
O 290822Z MAR 06
FM AMEMBASSY SEOUL
TO RUEHC/SECSTATE WASHDC IMMEDIATE 6975
INFO RUEHBJ/AMEMBASSY BEIJING 0395
RUEHMO/AMEMBASSY MOSCOW 7218
RUEHKO/AMEMBASSY TOKYO 0479
RUEHUM/AMEMBASSY ULAANBAATAR 1143
RHMFISS/COMUSKOREA J5 SEOUL KOR
RHHMUNA/CDR USPACOM HONOLULU HI
RHMFISS/COMUSKOREA J2 SEOUL KOR
RHMFIUU/COMUSKOREA SCJS SEOUL KOR
RHEHNSC/NSC WASHDC

UNCLAS SEOUL 001031

SIPDIS

SENSITIVE
SIPDIS

NSC FOR CHA

C O R R E C T E D C O P Y - PARA 1 AND 2 CORR'D

E.O. 12958: N/A
TAGS: [PREL](#) [ECON](#) [EAID](#) [KN](#) [KS](#)
SUBJECT: RECENT TRENDS IN PRC-DPRK ECONOMIC RELATIONS AND
IMPLICATIONS FOR INTER-KOREAN COOPERATION

SUMMARY

1. (SBU) Chinese economic ties with North Korea have expanded greatly in the past two years. Although the ROK welcomes the stabilizing effect that Chinese trade and investment brings to the DPRK, it is alarmed at the PRC's growing influence, to the point that ROK officials now routinely assert Beijing is attempting to turn North Korea into the "fourth province of Northeast China." In the worst case, Seoul fears Beijing will turn the DPRK into a client state and the ROK will lose forever the opportunity to reunify the Korean peninsula. Accordingly, as Chinese influence in the DPRK continues to grow, the ROK will feel increasing pressure to undertake a dramatic expansion of its own engagement with the North. END SUMMARY.

CHINA REMAINS DPRK'S BIGGEST TRADING PARTNER

2. (U) According to the Korea International Trade Association (KITA), trade between North Korea and China in 2005 hit a new high of USD 1.58 billion. As a result, the PRC continues to be the DPRK's biggest trading partner and, according to preliminary figures, is likely to account for over 50 percent of North Korea's overall trade in 2005.

(NOTE: Because most of the data on DPRK trade is based on mirror statistics collected by the Korea Trade & Investment Promotion Agency, exact annual figures on DPRK overall trade are usually not available until July of the following year. END NOTE.)

North Korea's trade with China is increasingly unbalanced, however, as its trade deficit with China nearly tripled in 2005, from USD 212 million in 2004 to USD 588 million. Imports rose 36 percent and exports dropped 14.3 percent during the same period.

HUGE GROWTH IN INVESTMENT IN TWO-YEAR PERIOD

¶3. (U) Chinese investment in North Korea has also increased dramatically in the past two years. Chinese investments, generally in the form of joint ventures, are mostly channeled to finance various resource and infrastructure projects in the North. In return, investors (most of whom are based in China's three northeastern provinces) are guaranteed special rights to use resources and ports for a certain period of time. The Ministry of Unification (MOU) estimates that PRC investment in 2005 doubled from USD 50 million in 2004 to a total of USD 100 million, accounting for approximately 85 percent of all DPRK in-bound investment. The surge in Chinese direct investment is even more pronounced when comparing the 2004 and 2005 figures with the 2003 figure of only USD 1.1 million.

FOOD AND ENERGY ASSISTANCE

¶4. (U) China remains one of the primary sources of food and energy assistance to the DPRK. According to estimates provided to poloff by the Ministry of Unification (MOU), the PRC is the source of approximately 60 percent of the DPRK's total energy imports (both commercial and non-commercial). The MOU also estimates that China gave a substantial amount of energy and technical assistance to the North in the form of long-term loans between 2001 and ¶2005. China has tried to reduce the financial burden of its bilateral relationship with the DPRK by substituting trade and investment for assistance. The chronic trade deficit that the North has with the PRC, however, suggests that a large portion of bilateral trade is 'de facto' aid.

JAPANESE TRADE DECLINES, CHINA FILLS THE VOID

¶5. (U) The sharp increase in PRC-DPRK trade is in contrast to the result of a steady decline in the DPRK's trade with Japan as mounting political tension surrounding the nuclear and abductee issues has cut into bilateral economic ties.

According to KITA, the level of Japan-DPRK trade declined from USD 1.3 billion in 2001 to USD 195 million in 2005 (an annual average decline of 32 percent), the lowest since ¶1977. Japan's share (17.8 percent) of North Korea's overall trade in 2001 was even greater than that of South Korea (15.1 percent), making it the second largest trading partner to the DPRK after China (27.6 percent); by 2004, however, Japan had fallen to fourth place with a mere 7.1 percent share in the DPRK's overall trade, behind China (39.0 percent), the ROK (19.6 percent), and Thailand (9.3 percent).

¶6. (U) At the same time, the recent decline in international aid has led Pyongyang to depend more on imported food and energy. In fact, food and energy comprise the top import items in the DPRK's trade with its major trading partners, especially China and Russia.

PRC SEEKS STABILITY, INFLUENCE AND TWO-KOREA STATUS QUO

¶7. (U) South Korean analysts see China's increasing economic engagement in North Korea as reflecting Beijing's strategic interests in: (1) preventing a North Korean collapse, which could in turn have a destabilizing effect on its own domestic security; (2) maintaining Chinese influence on the Korean peninsula, and thus check U.S. influence in the region; and (3) sustaining the two-Korea status quo. For the PRC, North Korea could be a major source for raw materials. At the same time, North Korea remains an ever-increasing market for Chinese goods. Based on these economic advantages, some analysts point to the possibility of China incorporating the DPRK into its development plans for its three northeastern provinces (Jilin, Liaoning and Heilongjiang).

¶18. (U) South Korean analysts also see North Korea seeking to increase its economic relations with the PRC to balance the growing economic leverage of the ROK (which is still considered a serious threat to the Kim Jong-il regime). The DPRK's interest in developing its backward economy has also played a role in cultivating Chinese economic involvement in the DPRK.

USD 2 BILLION IN CREDITS?

¶19. (U) Meanwhile, PRC-DPRK economic ties were also given a major boost by high-ranking political and economic exchanges. In particular, various bilateral institutional agreements to promote bilateral investment, and economic & technological cooperation were adopted during DPRK Premier Pak Pong-jus visit to China in May 2005 and President Hu Jintaos October 2005 visit to the DPRK. Media reports indicate that the "Economic and Technological Cooperation Agreement" adopted during Hu's visit is worth USD 2 billion in trade credits and investment.

DEPENDENCY ON CHINA MORE OBVIOUS "IN THE STREETS"

¶10. (SBU) According to a recent report by Dr. Cho Myung-chul of the Korea Institute for International Economic Policy (KIEP), the PRC's expanding economic relationship with the DPRK has not yet resulted in the North's structural dependence on the Chinese economy. Nevertheless, Cho's report emphasizes that North Korea's poorly developed manufacturing industry puts it at a disadvantage in its trade with the PRC. As a result, Chinese goods have become major import items for the DPRK. Moreover, large volumes of Chinese goods are entering the DPRK through Dandong and have become popular on the DPRK black market. According to media reports and Cho's in-depth interviews of North Korean refugees, as much as 80 percent of consumer goods found in the country's markets are Chinese products. The DPRK's economy also depends heavily on China in other areas, such as transportation and finance. In short, Cho's report shows that DPRK economic dependence on the PRC is even more evident at the "street level" than at the national level.

IMPLICATIONS FOR INTER-KOREAN COOPERATION

¶11. (SBU) In a March 17 meeting with poloff, Cho said the ROK needed to begin preparing for China's growing economic influence over the DPRK, as it would not only complicate the ROK's plans for inter-Korean economic cooperation, but also undermine South Korea's plans to reunify the Korean peninsula under democratic and market-oriented principles. ROKG officials routinely express concern about China's increasing economic influence in the DPRK. These officials say that China's increasing economic influence on the DPRK will naturally lead to more Chinese political influence in DPRK affairs. At worst, ROKG officials fear that the DPRK could be incorporated into the PRC as a "fourth northeastern province." Another scenario being discussed in Seoul describes the North Korean elite 'running' to the PRC for help in the event of a DPRK collapse, which will in turn provide the pretext for direct PRC involvement in North Korean affairs.

VERSHBOW